Supreme Court, U.S.
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No. 01-1424

IN THE

Supreme Court of the United States

JOHN N. BAIN and JOHN G. GILFILLAN, III,

Petitioners,

v.

FREDERICK F. BUECHEL, M.D., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS, STATE OF NEW YORK

REPLY BRIEF

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Petitioners John N. Bain and John G. Gilfillan, III (collectively, "Petitioners") submit this brief in further support of their petition for a writ of certiorari to review a decision of the Court of Appeals of the State of New York (the "Court of Appeals") that raises two issues of national significance worthy of review by this Court. The first concerns whether the courts below have impermissibly intruded upon federal authority and federal jurisdiction while the second implicates due process principles at the heart of the American judicial system.

If the decisions below are allowed to stand, patent lawyers practicing patent law and their clients will no longer be subject to and enjoy the uniform rights and standards of the PTO Code, 37 C.F.R. § 10.20, *et seq.* They will find their Section 10.64 patent fee arrangements re-characterized as a "business venture" and prohibited under state law. Patent fee arrangements will be subject to a balkanized scheme of regulation, whereby federally sanctioned agreements could be valid in some states but not others, based only on the vagaries of local law or procedure.

PRELIMINARY STATEMENT

Respondents open their brief with the allegation that the Petition "focuses on legal abstraction without regard for the facts of the case." Brief in Opposition ("Opp. Br.") at 1. This assertion is highly ironic because, in fact, there are no "facts of this case" at all. *This case* has never been tried. The New York courts refused to hold a trial. Instead, they deemed Petitioners bound to an adjudication of a prior action in which Petitioners were expressly relieved of liability by the denial of a motion to amend the complaint to bring causes of action against them.

Rather than concede that federal regulations expressly permit an equity fee for patent representation like the one at issue here, Respondents highlight the supposed "facts of the case" to characterize their fee arrangement as a "business deal" or as "a long-term business arrangement." But, *by their very nature* equity fees involve long-term financial interests in the

proceeds of a patent. This ignorance of the obvious is indicative of the weakness of Respondents' entire position on the legal issues. Thus, Respondents pick and choose excerpts from a *prior* trial against *someone else* to deflect attention from the manifest validity of Petitioners' fee arrangement under federal law.

If and when Petitioners get a day in court they will be able to rebut all of the mischaracterizations of the fee arrangements that Respondents have extracted from the record in the prior *Rhodes* action. For now, however, all that is relevant is that: (1) federal law expressly permits equity fees; (2) this case is an attack on a patent-related equity fee; and (3) this case belongs exclusively in federal court as a jurisdictional matter.

By attempting to trump the black-letter law of jurisdiction with the supposed "facts of this case," Respondents also demonstrate the critical significance of Petitioners' due process appeal. Petitioners dispute all of the characterizations of the fee arrangements put forth by Respondents, but Petitioners have never been able to have their case heard. Petitioners would have tried *their* case had the motion to amend been granted. They would have been heard. But the motion to amend was denied, and Petitioners, naturally, went home.

But for the denial of due process, Petitioners would have proven that their fee arrangement was lawful, indeed fairly typical. They would have proven that they rendered good service in a patent case for a fair fee. They would have proven that it was their clients, not them, who manipulated the legal system for illicit profit. They would have proven, in short, that all of the "facts of this case" that form the bases for Respondents' opposition are not facts at all.

Petitioners contend that it is a *prima facie* and irrefutable denial of due process for a court to deny a motion to amend (on prejudice grounds no less), and then later bind the defendants relieved of liability by that denial to the outcome of the case they exited. This Court should not permit the perpetuation of

those errors in reliance on an opposition brief that would bootstrap a failure of due process below into the "facts of the case" here.

FURTHER REASONS FOR GRANTING THE WRIT

I. This Is The Appropriate Case To Determine Whether A State Court Applying State Law Has The Jurisdiction And Authority To Invalidate An Equity Fee Agreement That Is Sanctioned By 37 C.F.R. § 10.64

The Code of Federal Regulations provides, in relevant part, that Petitioners, as patent practitioners, may: "In a patent case, take an interest in the patent as all or part of his fee." 37 C.F.R. § 10.64(3). The Court of Appeals ruled that federal patent law gives a "patent attorney the right to receive an interest in a client's patent as full or partial payment . . . [but] the need for disclosure mandated by the [New York] Code of Professional Responsibility governing the practice of law in this state is not obviated." App. 14a. Thus, PTO-regulated patent attorneys, like Petitioners, who practice patent law in New Jersey (or in any other state) and service New Jersey-based clients, like Respondents, must follow the draconian disclosure requirements of the New York Code of Professional Responsibility (found nowhere in federal law) lest their equity fee arrangements be declared invalid decades later by New York courts. That decision should not go without review by this Court.

It cannot be disputed that New York law, as articulated below, imposes additional burdens found nowhere in federal law. According to the state courts below, for a federally sanctioned fee agreement to be upheld by a New York state court, the patent attorney must have made detailed disclosures of: the so-called inherent conflict between clients and their equity fee counsel; the alleged great potential for a lawsuit between clients and their equity fee counsel; the purported loss of objectivity by the equity fee counsel; the equity lawyer's profit motive. App. 98a-102a. On top of that, the New York courts have ruled that patent attorneys must insist that

their clients engage the services of independent counsel to scrutinize the equity fee arrangement. *Id.*

Petitioners submit that New York's far-reaching disclosure requirements are in conflict with the letter and spirit of (and effectively nullify) the PTO Code — whose objective is to assist the cash-starved inventor's effort to secure patent counsel, not require the engagement of a second lawyer to look over the shoulder and endorse the fee arrangements of the first. Neither the PTO nor any federal court has ever imposed such requirements on a federal patent attorney's fee arrangement. Whether the New York courts' belief and Respondents' contention that the New York Code and the PTO Code are "the same" has never been tested before the PTO or a federal court, where such a question belongs. In any event, the New York courts' holding that equity fees are "of dubious propriety" would appear to answer that question.

The determination of whether Petitioners' conduct satisfied the requirements of the PTO Code should and can appropriately be made only by the federal courts, pursuant to 28 U.S.C. § 1338. Federal jurisdiction under Section 1338 extends to any case in which the plaintiff's right to relief depends upon a substantial question of federal patent law, including where some rights or interest will be defeated or sustained by a construction of federal patent law. *See Christianson v. Colt Ind. Operating Corp.*, 486 U.S. 800, 808-09 (1988); *Helfgott & Karas, P.C. v. Dickerson*, 209 F.3d 1328, 1334 (Fed. Cir. 2000); *Franchi v. Manbeck*, 972 F.2d 1283, 1286 (Fed. Cir. 1992). Here the court below concedes that Section 10.64 applies. *See* App. 14a. It should have conceded its lack of jurisdiction at that point as well. Instead, it held that the New York Code also applies — a holding that depends on a construction of the PTO Code, a matter Congress has delegated exclusively to the federal courts.[1] *See* 28 U.S.C. § 1338.

1. More precisely, the Federal Circuit is the court Congress has charged with the obligation to promote uniformity in the field of patent

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Respondents characterize Petitioners' equity in their patents (which eventually took the form of shares of a trust for tax reasons) taken in lieu of a cash fee, as a "joint business venture." This is an erroneous conclusion of law that Respondents' brief casts as "fact." This characterization ignores that the New York courts held the fee agreement void *ab initio*, *i.e.*, before it was in a corporate or trust form and when the only agreement was that Petitioners would prosecute a patent on Respondents' "floating center prosthetic joint" invention in exchange for equity in that patent. *See* App. 1a-2a. Further, an equity fee is *always* an ongoing interest in a "business" in the sense explicitly permitted by Section 10.64 — a mutual interest in the proceeds of the underlying inventions.[2] The characterizations and forms of the actual interest are beside the point. The Court should hear this case to determine whether the validity of that equity fee arrangement under Section 10.64 is — or is not — a question

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law, responsibility to decide what patent law permits and prohibits, and the "only appellate court with the right and obligation to determine the extent that federal patent laws preempt state law." *Midwest Indus v. Karavan Trailers, Inc.*, 175 F.3d 1356, 1360-61 (Fed. Cir. 1999); *see In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1322-1324 (Fed. Cir. 2000). In this case, the New York courts overstepped whatever *de minimis* responsibilities they may have in the Congressional scheme for the regulation of patent law and its practice.

2. Respondents' contention that Section 10.64's express authorization of the fee arrangement with Petitioners is inapplicable because Petitioners ultimately agreed to provide legal services beyond simple patent prosecution services makes no sense in logic or law. Respondents' position would lead to the absurd result that patent practitioners who agree only to prosecute patents on behalf of their clients may receive an equity fee but practitioners who agree to prosecute that patent and then protect it may not, unless he charges an additional cash fee. Thus, remarkably, Respondents would penalize patent attorneys who agree to provide their cash starved clients with additional services. There is nothing in the letter or spirit of the PTO Code to suggest that Congress intended that such a limit be placed on the relationship between patent attorneys and their clients.

that can be decided by the state courts and by reference to the New York Code. Petitioners submit that it cannot. The implications for patent practitioners and notions of federalism are manifest. This is the case in which the Court should provide guidance to the lower courts on the appropriate division of labor between state and federal courts on these increasingly common fee arrangements.

It has been decades since the Court last spoke on the proper and respective roles of the states, the PTO and the federal courts in the regulation of the conduct of patent attorneys and their relationships with their clients in *Sperry v. State of Fla. Ex rel. Fla. Bar*, 373 U.S. 379 (1963). In *Sperry*, the Court was clear that states are preempted from regulating the practice of federal patent practitioners and taking action against them in a way that restricts their ability to perform federally sanctioned actions. The decision below empowers the state courts to do just that, by invalidating equity fee arrangements expressly authorized by federal law as a mechanism to provide cash-starved inventors with patent counsel.

Petitioners respectfully submit that it is time for the Court to re-visit how much state regulation of the equity fee arrangements between patent attorneys and their clients, if any, is appropriate in light of Section 10.64 and the federal policies embodied in the patent law and its practice.

II. This Is The Appropriate Case To Affirm That The Principles Of Due Process Articulated And Applied In *Richards v. Jefferson County* And Its Progeny Preclude State Courts From Applying Collateral Estoppel On The Basis Of A Common Interest

The due process concerns in this case range from acute and particular (*see* Part II.A, *infra*) to acute and universal (*see* Part II.B, *infra*).

A. Application of Collateral Estoppel To Petitioners — Successful Litigants In *Rhodes* — Is A Due Process Violation

Respondents attempted to litigate the validity of Petitioners' fee arrangement (their claim in this case) in the *Rhodes* action and lost. The *Rhodes* trial court denied Respondents' motion to assert a claim to invalidate the fee arrangement against Petitioners. *See* App. F. Respondents went on to try the validity of Rhodes' fee arrangement in the *Rhodes* action against Rhodes alone. *See* App. G.

Petitioners prevailed in the *Rhodes* case. On grounds of tardiness, prejudice and inability to take discovery, Petitioners defeated the motion to amend. Respondents did not appeal. Under most case law that speaks to this subject, including New York federal court cases, that was enough to bar subsequent litigation against Petitioners. *See, e.g., Landscape Props., Inc. v. Whisenhunt*, 127 F.3d 678, 683 (8th Cir. 1997) ("It is well settled that denial of leave to amend constitutes *res judicata* [against plaintiffs] on the merits of the claims which were the subject of the proposed amended pleading."); *EFCO Corp. v. U.W. Marx, Inc.*, 124 F.3d 394 (2d Cir. 1997); *King v. Hoover Group, Inc.*, 958 F.2d 219, 222-23 (8th Cir. 1992); *Huck on Behalf of Sea Air Shuttle Corp. v. Dawson*, 106 F.3d 45, 49-50 (3d Cir. 1997); *Walton v. Eaton Corp.*, 563 F.2d 66 (3d Cir. 1977). The courts below, however, inverted the traditional approach and held that even though Petitioners won, their former partner lost, and thus, so did they.

Respondents cite general formulations of the doctrine of collateral estoppel that emphasize "notice" and a "fair opportunity to litigate." Respondents' Br. at 27. We agree with those general formulations. Here, however, Petitioners had notice of the claim against their former partner, but operated under assurances from Respondents that no action would be brought against them. In 1995 that changed with the filing of the motion to amend. After Petitioners prevailed on that motion,

they had notice *from a court* that their rights would not be litigated in *Rhodes*, and perhaps not be litigated ever. They went home, only to be accused later of a "conscious, tactical decision not to take a more active role in that litigation." Opp. Br. at 25, *quoting* App. 11a.

Petitioners submit that the treatment of this issue by Respondents and the New York Court of Appeals is altogether too facile. It is not sufficient to say that the denial of the motion to amend meant nothing of substance — *i.e.*, only that a monetary judgment would not be entered against Petitioners. The case law says otherwise, and equally important, the motion to amend was denied on *grounds of discovery prejudice*.[3] To bind Petitioners later is far *more* prejudicial. Respondents have no answer for this.

Most important, the case law on "notice" and "fair opportunity to litigate" is grounded in practical realities. The *Rhodes* court did not say "motion denied but watch out because we may bind you anyway." No, the *Rhodes* court gave "notice" that the *Rhodes* action was *not* an action against Petitioners Bain and Gilfillan. To retroactively construe it to be an action against them, on grounds of "privity," "notice," "opportunity" or whatever, is to distort constitutional principles beyond all recognition.

One cannot have "notice" of a claim against oneself when a court has held that the claim is against *only* someone else, and has held that it is *not* against you.

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3. Respondents have never cited a reported decision from any court binding party "A" to a judgment on a claim in a prior case that was asserted against party "B" in that prior case but not allowed to be asserted against party "A" in that same prior case. Yet, each of the three lower court decisions take that unprecedented action — binding Petitioners to the decision in *Rhodes* that invalidates Rhodes' fee arrangement notwithstanding the denial of the motion to amend — albeit for different reasons.

B. Aside From The Motion To Amend, The Decisions Below Misapprehend Collateral Estoppel And Due Process Principles

The Court of Appeals' collateral estoppel reasoning rests on the dubious and unconstitutional notion that a "common interest" shared with Rhodes in the validity of his fee arrangement is sufficient to preclude Petitioners' from litigating the validity of their own fee arrangements and from discovery through trial. Magnifying the due process implications of this case is the Court of Appeals' concern with "efficiency" and "consistent judgments" in lieu of an actual trial of Respondents' claims against Petitioners. This discredited approach to due process taken by the New York courts cries out for review by this Court. As Judge Levine so forcefully noted in his dissent to the Court of Appeals' decision, *Richards v. Jefferson County*, 517 U.S. 793 (1996), and its progeny should have precluded the reasoning manifest in the majority's opinion.[4]

Neither Respondents nor any court in this case has suggested that there was any legal relationship between Rhodes and Petitioners at the time the *Rhodes* action was commenced. Rhodes and Petitioners had not been law partners for more than ten years at the time of the *Rhodes* trial. Respondents point to nothing in the record to suggest that Rhodes' was accountable to Petitioners in the conduct of his case. But for their "common interest" in the genesis of, but certainly not the final form of, the federally sanctioned fee arrangement, Rhodes and Petitioners were effectively strangers.[5] As Judge Levine recognized in his

4. Respondents artificially attempt to limit *Richards* to a "common-law kind of class action" and "matter[s] of public concern." Opp. Br. at 28. Yet, these restrictions are found nowhere in the *Richards* line of cases. *See Becherer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 193 F.3d 415 (6th Cir. 1999); *Tice v. American Airlines, Inc.*, 162 F.3d 966 (7th Cir. 1999).

5. None of the decisions below make any findings concerning the scope of disclosures made *by Petitioners* prior to the 1983 formation of

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dissent, Petitioners "fall squarely under the factors relied on in *Richards* to find a due process violation." App. 37a. This Court should hear this case to address the failure to heed *Richards* and halt the state courts from issuing judgments that bind interested, but not adequately represented parties. That Petitioners were not "adequately" represented in the *Rhodes* action is obvious. Rhodes' counsel failed to even raise the fact that Section 10.64 permits a patent attorney cannot take an equity interest in a patent.

CONCLUSION

For these additional reasons, Petitioners respectfully submit that the Court should grant a writ of certiorari to the New York Court of Appeals to review the important issues of patent law, federalism and due process that are raised by this case.

Respectfully submitted,

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Biomedical Engineering Trust (Trust I). In fact, the only record evidence cited by the Court of Appeals concerning Petitioners disclosures was in Judge Levine's dissent — Petitioner Bain advised Respondents to consult an independent attorney prior to the formation of Trust I. *See* App. 22a-23a.